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In The

Supreme Court of the United States

October Term, 1993

E.J. McMANUS AND
ALL OTHERS SIMILARLY SITUATED,

Petitioners,

v.

STATE OF IOWA, IOWA DEPARTMENT OF
REVENUE AND FINANCE AND GERALD BAIR,

Respondents.

Petition For Writ Of Certiorari
To The Supreme Court Of Iowa

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW

1. Whether Petitioner's claims are moot.

2. Whether the Iowa Supreme Court decision was based solely on state law questions regarding the proper procedure to follow when seeking an Iowa tax refund.

3. Whether Petitioner is seeking review of issues which were not decided by the Iowa Supreme Court.

4. Whether the Iowa Supreme Court decision was correct in finding that the lower court properly dismissed Petitioner's case because he had failed to exhaust administrative remedies.

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OPINIONS BELOW

It should be noted that among the technical corrections to the Iowa Supreme Court's opinion which were filed on July 21, 1993, by Justice Larson, the author of the Court's opinion, was one which changed the first complete sentence on page 60 of the Petition for Writ of Certiorari. That sentence of the Iowa Supreme Court's opinion now reads, "The district court properly dismissed the claim under § 1983 because there are adequate state administrative remedies, and McManus failed to exhaust them." *McManus v. Dept. of Revenue and Finance*, 499 N.W.2d 726, 728 (Iowa 1993).

ADDITIONAL STATUTES INVOLVED

In addition to provisions included in the Petition's appendix, the following Iowa statutes are relevant.

Iowa Code § 421.10 (1991) Appeal period – denial of taxpayer's claim.

> The appeal period for revision of assessment of tax, interest, and penalties set out under section 422.28, 422.54, 452A.64, 453A.29, or 453A.46 applies to appeals to notices from the department denying changes in filing methods, denying refund claims, and denying portions of refund claims for the tax covered by that section.

Iowa Code § 422.28 (1991) Revision of tax.

> A taxpayer may appeal to the director for revision of the tax, interest or penalties assessed at any time within sixty days from the date of the

notice of the assessment of tax, additional tax, interest or penalties. The director shall grant a hearing and if, upon the hearing, the director determines that the tax, interest or penalties are excessive or incorrect, the director shall revise them according to law and the facts and adjust the computation of the tax, interest or penalties accordingly. The director shall notify the taxpayer by mail of the result of the hearing and shall refund to the taxpayer the amount, if any, paid in excess of the tax, interest or penalties found by the director to be due, with interest after sixty days from the date of payment by the taxpayer at the rate in effect under section 421.7 for each month or a fraction of a month. The director may, on the director's own motion at any time, abate any portion of tax, interest or penalties which the director determines is excessive in amount, or erroneously or illegally assessed. The director shall prepare quarterly reports, which shall be included in the annual statistical reports required under section 422.75, summarizing each case in which an abatement of tax, interest or penalties was made under this section, but a report shall not disclose the identity of the taxpayer.

STATEMENT OF THE CASE

At page 13 of McManus' Petition for Writ of Certiorari, he states that the Iowa Department of Revenue and Finance (Department) refused to hear his case. In reality, the Department had simply not yet acted on McManus' refund claim. It had neither allowed nor denied the refund, just as it had not acted on thousands

of other federal retirees' refund claims. At no time did McManus formally ask the Department to act on his claim nor did he ever ask a court to order the Department to act.

At page 14 of McManus' Petition for Writ of Certiorari, he states that Arlo Hagge brought the same claim in Iowa District Court but the Department agreed in writing to hear Hagge's claim. Mr. Hagge did not, however, go directly into District Court without first exhausting his administrative remedies. As set forth in the Iowa Supreme Court's opinion in *Hagge v. Iowa Department of Revenue and Finance*, No. 90-20-2-0216 (Iowa Sup. Ct. July 21, 1993), which is included in the Petition's appendix, the Department issued a letter denying Arlo Hagge's claim for refund for Iowa income taxes attributable to federal pension income. (Pet. App. 65). Hagge timely filed a Protest to the denial of refunds. The parties submitted the contested case directly to the Director of Revenue and Finance based on a stipulated factual record. All issues were presented to the Director for purposes of satisfying the requirement of exhaustion of administrative remedies. The Order of the Director was issued. Arlo Hagge then filed a judicial review action in Iowa District Court. Unlike McManus, the Petitioner in this case, Arlo Hagge, did not file a petition for judicial review in District Court until *after* he had exhausted his administrative remedies.

SUMMARY OF THE ARGUMENT

McManus' claim for recovery of income taxes is moot. As a result of the Iowa Supreme Court's recent decision in *Hagge v. Iowa Department of Revenue and Finance*, Docket No. 90-20-2-0216 (Iowa Sup. Ct. July 21, 1993), as revised on August 24, 1993, McManus will be refunded whatever tax he paid on federal pension income for which he timely filed refund claims. (See Petition App. 82).

Review of the Iowa Supreme Court's decision does not present an important question of federal law. The Iowa Supreme Court's decision was based solely on the required state procedures for getting into state district court to challenge state agency action. No federal questions were decided by the lower court.

The issues Petitioner presents regarding the availability of a class action and of a remedy under 42 U.S.C. § 1983 were never decided by the Iowa Supreme Court. The Iowa Supreme Court decided that McManus' suit was premature because he had not exhausted administrative remedies. The Court stated that because the suit was premature, the additional issues that rested on McManus' ability to maintain the action were moot. (Petition App. 60).

The District Court's decision to dismiss Petitioner's lawsuit, which was affirmed by the Iowa Supreme Court, was correct. Iowa law requires that a taxpayer exhaust his administrative remedies available through the Department before seeking judicial review of Department action. Iowa Code sections 17A.19(1) and 422.29(1). McManus had allegedly filed a refund claim with the Department.

The Department, however, never denied his claim. Therefore, the only agency action that McManus could have complained about and sought judicial review of at the time of his District Court lawsuit was the Department's failure to act on his refund claim. *See* Iowa Code § 17A.2(9)(1991) ("agency action" includes "a failure to act, or any other exercise of agency discretion or failure to do so, or the performance of any agency duty or the failure to do so"). His "Petition for Judicial Review" did not, however, present the issue of the Department's failure to act on his refund claim.

REASONS TO DENY THE PETITION

I. PETITIONER'S CASE IS MOOT, BECAUSE THE DEPARTMENT WILL BE PAYING PETITIONER AND OTHER FEDERAL RETIREES WHO FILED TIMELY REFUND CLAIMS THE TAX REFUNDS SOUGHT BY PETITIONER.

McManus' claim for recovery of income taxes paid which were unconstitutional under *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), is moot. The Iowa Supreme Court has already decided all relevant legal issues regarding McManus' right to a refund in its recent decision in *Hagge v. Iowa Department of Revenue and Finance*, Docket No. 90-20-2-0216 (Iowa Sup. Ct. July 21, 1993), as revised on August 24, 1993. (This decision, including the revision, is set forth at pages 62-83 of the Petition's appendix.)

It is clear from the opinion in *Hagge*, combined with this Court's decision in *Barker v. Kansas*, 112 S.Ct. 1619

(1992) (military retirees had to be treated the same as state retirees with regard to the taxation of retirement income), that *all* federal retirees who filed timely refund claims will be refunded the Iowa income tax paid on their federal retirement income. The Iowa Supreme Court stated:

> Thus we hold that in order to equalize the tax burden on state and federal retirees, the department must authorize refunds to those taxpayers, like Hagge, who timely filed amended returns within the limitation period.

(Pet. App. 82). The Department has every intention of complying with *Hagge* and paying McManus' claimed refund of Iowa income tax paid on federal pension income. The only reason McManus has not already received his money is that the Department is waiting for the Iowa Legislature to tell it whether to pay the approximately $45 million in refunds all at once or to pay it in installments covering up to four years, as allowed by the Court in *Hagge*. *See* Pet. App. 83. McManus has absolutely nothing to gain by pursuing his case. He will be receiving part, if not all, of his refund within a year and will have received his entire refund amount, with interest, within four years.

II. THE IOWA SUPREME COURT'S DECISION AFFIRMING THE DISTRICT COURT'S DISMISSAL OF PETITIONER'S TAX REFUND ACTION DOES NOT PRESENT ANY IMPORTANT QUESTIONS OF FEDERAL LAW.

The Iowa Supreme Court's decision which Petitioner seeks to have reviewed by certiorari was based solely on

the procedures required by state law for getting into state district court to challenge state agency action. No federal questions were decided by the lower court. The Iowa Supreme Court relied upon Iowa Code section 17A.19 (1991) and prior Iowa caselaw regarding that Iowa Code section. *See* Pet. App. 54-60.

III. THE ISSUES REGARDING THE AVAILABILITY OF A CLASS ACTION AND OF A REMEDY UNDER 42 U.S.C. § 1983 WERE NEVER DECIDED BY THE IOWA SUPREME COURT.

The issues Petitioner presents regarding the availability of a class action and of a remedy under 42 U.S.C. § 1983 were never decided by the Iowa Supreme Court. The Iowa Supreme Court decided that McManus' District Court lawsuit, including the 42 U.S.C. § 1983 claim, was premature because he had not exhausted administrative remedies as required by Iowa Code section 17A.19 (1991). (Pet. App. 59-60 and *McManus*, 499 N.W.2d 726, 728 (Iowa 1993)). Having decided that the § 1983 claim was properly dismissed because appropriate procedures had not been followed in presenting the issue, the Iowa Supreme Court did not decide the merits of the claim.

Similarly, the issue of the availability of a class action lawsuit was not decided by the Iowa Supreme Court. The Court stated:

> Because we conclude that any suit attempting to recover the refund or damages under § 1983 is premature for the reasons discussed, additional issues raised by McManus that rest on his ability to maintain this action are moot.

(Petition App. 60). The availability of a class action was one of the issues not reached by the Iowa Supreme Court.

IV. THE IOWA SUPREME COURT DECISION WAS CORRECT IN FINDING THAT THE LOWER COURT PROPERLY DISMISSED PETITIONER'S CASE BECAUSE HE HAD FAILED TO EXHAUST ADMINISTRATIVE REMEDIES.

McManus was not entitled to bring an action in Iowa District Court seeking the remedies requested in his "Petition For Judicial Review." An Iowa District Court reviewing action of a state agency exercises only appellate jurisdiction. It has no original authority to declare the rights of the parties or the applicability of any statute or rule. *Teleconnect Co. v. Iowa State Commerce Com'n*, 366 N.W.2d 515, 518-19 (Iowa 1985). McManus' refund claim had not been denied by the Department. Therefore, McManus could not challenge the denial of his refund claim. The only remedy McManus could have sought in a court action at the time he filed his Petition for Judicial Review was a ruling that the Department had to immediately act upon his refund claim rather than awaiting the outcome of *Hagge* and federal retiree cases which were before this Court. *See* Iowa Code § 17A.2(9) (1991) ("agency action" includes "a failure to act, or any other exercise of agency discretion or failure to do so, or the performance of any agency duty or the failure to do so"). His "Petition for Judicial Review" did not, however, present the issue of the Department's failure to act on his refund claim.

The provisions in Iowa Code § 17A.19 constitute the exclusive means of judicial review of agency action in Iowa. *Salsbury Laboratories v. Iowa, Etc.*, 276 N.W.2d 830, 833 (Iowa 1979). Under § 17A.19(1), a party must have exhausted all adequate administrative remedies before being entitled to seek judicial review of final agency action. Even an inadequate administrative remedy must be exhausted if judicial review from the final agency action is adequate. *Salsbury Laboratories v. Iowa, Etc.*, 276 N.W.2d 830, 837 (Iowa 1979). The exhaustion of remedies rule "prevents a premature transfer to courts of duties imposed by law on administrative agencies and prevents interruption of administrative process, insuring an orderly procedure." *Dehning v. Eads*, 201 N.W.2d 454, 455-56 (Iowa 1972).

The issues to be decided regarding McManus' refund claim directly affected matters pending before the Department. Therefore, administrative exhaustion was to precede the judicial inquiry regarding those issues. *See Shell Oil Co. v. Bair*, 417 N.W.2d 425, 429 (Iowa 1987) ("[W]here the constitutional issue sought to be raised directly affects a matter pending before an agency, administrative exhaustion should ordinarily precede a judicial inquiry into the statute's validity."). As stated in *Shell* with respect to facial constitutional issues, the issues to be decided in determining whether federal retirees were entitled to the relief sought by McManus are more effectively presented for adjudication based upon a specific factual record developed before the agency entrusted with the determination of the adjudicative facts. *Id.* at 430.

There is an exception in state tax matters to the general rule prohibiting exhaustion requirements for § 1983 actions. *Hogan v. Musolf*, 471 N.W.2d 216, 222 (Wis. 1991), *cert. denied*, 112 S.Ct. 867 (1992) (federal retirees' case based on *Davis*). A 42 U.S.C. § 1983 challenge to state taxation is not allowed in state courts where there is an adequate state administrative remedy available. *See, e.g., id.; Nutbrown v. Munn*, 811 P.2d 131 (Or. 1991), *cert. denied*, 112 S.Ct. 867 (1992) (federal retirees' case based on *Davis*). "[S]tate administrative tax procedures should not be undermined by sec. 1983 claims." *Hogan*, 471 N.W.2d at 222. Non-interference with state taxing schemes was Congress' primary purpose in enacting the Tax Injunction Act preventing challenges to state taxes in federal court. *Id.* at 222-23; *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 110 (1981). "That purpose is defeated regardless of whether a state court or federal court entertains a sec. 1983 claim without requiring the plaintiffs to resort to the state's administrative procedures." *Hogan*, 471 N.W.2d at 223.[1]

A state's exhaustion requirement is valid if the state remedies are "plain, adequate, and complete." *Id.* at 223. Iowa's administrative remedies meet this standard in the same way that Wisconsin's administrative remedies did in the *Hogan* case. The aggrieved taxpayer can apply for a refund with the Department. If the Department denies the refund claim, Iowa law provides for a full hearing

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[1] The jurisdictional prohibition of the Tax Injunction Act applies to civil rights actions brought under 42 U.S.C. § 1983. *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 67 L.Ed.2d 464, 101 S.Ct. 1221 (1981).

before the agency which allows the taxpayer to raise any and all legal arguments, including constitutional objections, concerning the request for income tax refunds. *See* Iowa Code §§ 421.10 and 422.28 (1991). The Department's decision is reviewable by the courts on judicial review. Iowa Code §§ 17A.19 and 422.29(1) (1991). This procedure "offers to the reviewing courts the benefit of the agency's findings and conclusions in an area in which agencies have special expertise." *Hogan*, 471 N.W.2d at 223. The fact that the same relief cannot be obtained under the state administrative remedies as can be obtained in a section 1983 action does not cause the remedy to be inadequate. *Id.* at 223; *Nutbrown*, 811 P.2d at 141. If taxpayers receive the relief they would be entitled to under an appropriate, constitutional reading of the Iowa tax system, they have no further claim. *Nutbrown*, 811 P.2d at 141.

McManus has "not yet suffered a harm that would require any relief under § 1983, and will not have suffered such harm unless [his] administrative remedies do not give [him] all [he] claim[s] under [his] interpretation of the tax laws and the United States Constitution." *Nutbrown*, 811 P.2d at 142. As discussed previously with regard to the mootness of the issues being raised, McManus will receive the refund he seeks. The Department will be paying all timely claims for refunds of Iowa income tax paid on federal pension income during the time period when state retirement income was exempt. If, by exhausting his administrative remedies, a taxpayer obtains the relief under the tax laws that he seeks, the need for § 1983 litigation vanishes. "That is a sufficient

reason to require exhaustion." *Nutbrown*, 811 P.2d at 142-43.

CONCLUSION

For the above stated reasons, the Department of Revenue and Finance respectfully requests that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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